DAIRY INSTITUTE *of California*

July 14, 2006

Mr. David Ikari, Chief
Dairy Marketing Branch, and
Mr. John Lee, Chief
Milk Pooling Branch
California Department of Food and Agriculture
560 J Street, Suite 150
Sacramento, CA 95814

RE: July 6, 2006 Milk Movement Provisions Hearing -- Post Hearing Brief

Mr. Hearing Officer and Members of the Panel:

Dairy Institute appreciates the opportunity to submit the following post-hearing brief to respond to questions from the panel and to amplify portions of our testimony presented in Sacramento on July 6, 2006. The paragraphs below clarify some of the arguments put forth in our testimony.

The panel asked me to consider the question of how maintaining competitive parity among processors should be weighed against the pool cost to producers of the transportation and allowance credit system. In response to the panel's question, I noted that California processors competing in a market area should not be disadvantaged relative to each other with regard to securing milk supplies, but acknowledged that transportation allowances and credits should be structured so as to move milk in an efficient manner so as to minimize the cost to the pool. Based on comments by panel members, there seemed to be some concern that adoption of our position, which involves eliminating shortfalls on all but the most distant milk serving the Class 1 market, would lead to inefficient milk movements and result in a higher cost to the pool. There are two considerations that I believe justify some deviation from a rigorous application of milk movement efficiency as it often has been defined.

The first of these considerations is the competitiveness of the milk supplying sector. In response to the panel's question, I noted that it was important that there be adequate numbers of suppliers serving the Class 1 market so that the market would remain a competitive one. I cited our members' past experience with the Southern California Milk Marketing Agency (SCMMA) as evidence of the kinds of market imperfections that can occur when there are too few

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sellers in the marketplace. In particular, over-order premiums were expanded greatly and retail prices were unreasonably enhanced as a result. In setting prices and policy, the Department has a statutory responsibility to provide for pricing policies (which include transportation allowances and credits), that result in prices to consumers which are fair and reasonable. When prices to consumers deviate from the competitive norm, as when they are increased by the exertion of the market power of one supplier, consumers are not getting milk at prices that are fair or reasonable. We therefore urge the Department to set transportation allowance and credit rates such that multiple suppliers are able to serve the Class 1 market.

The second consideration is the competitiveness of fully regulated California fluid processors in the marketplace. Obviously, pool revenues are diminished when California-based Class 1 plants are unable to compete with out-of-state processors for fluid milk sales. In recent years, processors located outside California have been able to take sales away from California processors for a variety of reasons. While some panel members appear to be concerned that the costs of transportation credits might exceed the cost of transportation allowances on comparable volumes of milk, the fact remains that some plants are not able to take all the milk they need in ranch to plant form.

It might be tempting for the panel to conclude that this is not the state's problem. That is, panel members might be inclined to reason that the state has no obligation to assure that these plants, which are not able to take ranch to plant milk, can get their supplies at order prices (i.e. without having to subsidize the haul). However, implicit in this reasoning is the assumption that the Class 1 sales that might be lost by these "supply challenged" plants would be acquired by other California-based processors, and therefore, that pool revenues would be unaffected or even enhanced as more milk would move ranch to plant at lower cost to the pool.

Unfortunately, there is a strong likelihood that such lost business would be acquired by out-of-state processors rather than by California plants, and while the pool might save the costs of the "fully compensating" transportation credits, it would lose the Class 1 differential revenue associated with these sales. Thus, if the plants that are currently receiving plant-to-plant milk are not kept competitive, pool revenues would likely be reduced rather than increased, and California producers would be worse off, not better off. In today's market environment, it is essential that <u>all</u> fully regulated California fluid processors are able to attract milk to their plants with out having to subsidize the haul. Dairy Institute appreciates the opportunity to submit this post-hearing brief, and we appreciate the hearing panel's consideration of our view.

Sincerely,

William G. Schiek

William Schiek
Economist